Financial Strategies

IRA ROLLOVERS: UNDERSTANDING THE NEW RULES

by **DAVID J. SCHILLER, JD** *Contributing author*

A tax lawyer was challenged by the IRS on the way he was taking advantage of the IRA Rollover Rules. He lost, and now the rules have been modified for all of us.

FOLLOWING THE TAX court decision from earlier this year, Bobrow vs. Commissioner, the "once a year" Rollover Rules are now interpreted differently. Historically, taxpayers have rolled over each separate Individual Retirement Account (IRA) one time each year on a tax-free basis.

For example, if you have $200,000 in one account and $300,000 in a different account, you could do one rollover from each account without violating the one rollover per year rule. Internal Revenue Service (IRS) Publication 590 specifies that the rule is on a per-IRA basis, but the tax court in the Brobrow case concluded that even though the IRS improperly described the "once a year" rollover rule in its own publications, taxpayers cannot rely on the IRS guidance when it is more generous than the letter of the law.

The IRS will start enforcing the new rule in 2015. This will limit you to one IRA rollover per year, regardless of how many accounts you have.

For this purpose, each spouse is treated as a separate taxpayer, so the wife can do one rollover and the husband can do his own rollover without violating the new rule. The one-year period is measured from the original withdraw of funds and is based on the exact date. For example, if funds are withdrawn on January 21 and redeposited into a different IRA on March 15, the next rollover withdrawal cannot occur until after January 21 of the next year.

It is considered a rollover when the funds come out of the IRA and are payable to you, then you deposit an equivalent amount of money within 60 days into another IRA. If the funds are payable to you, it is treated as a rollover after the money is redeposited within 60 days.

Some people treat the 60 day period as an interest-free swing loan. If instead you transfer money directly from one IRA to another and the transfer is made to the new custodian and is not paid to you, it is not treated as a rollover and you can make unlimited transfers each year.

Similarly, when you move money from a qualified plan like a 401(k) plan into an IRA, it is not treated as a rollover.

When you convert a traditional IRA into a Roth IRA, it is also not treated as a rollover and the once-a-year limitation does not apply. However, if you move assets from a Roth IRA into a different Roth IRA, you can do so once per year. You can, in addition, move funds from a traditional IRA into a traditional IRA, because each transaction is treated separately and has its own once-a-year rollover limitation.

If you have a second rollover within the same 365-day period, the second distribution cannot be redeposited into an IRA and is treated as a distribution, not a rollover. With a traditional IRA, this results in income taxes on the distribution and a 10% penalty if the taxpayer is under age 59-1/2.

If you deposit the funds into an IRA, and it is the second time within a year, such funds are subject to a 6% excise tax annually for each year or a portion of a year in which the funds improperly remain inside the IRA.

Most pension attorneys recommend that clients make direct transfers from one IRA to another to avoid the possibility of mishandling a rollover. If you make a rollover mistake, the IRS does not have the power to forgive, and must impose taxes. ■

David J. Schiller, JD, is a tax and estate-planning specialist and Medical Economics editorial consultant based in Norristown, Pennsylvania. Send your financial questions to **medec@advanstar.com**.